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In The

Supreme Court of the United States

October Term, 1990

RODNEY D. HENDRICK,

Petitioner,

versus

H.E. AVENT, ET AL., AN UNINCORPORATED ASSOCIATION, H.E. AVENT, MARK S. AVENT, BRANTLEY T. BURNETT, W.J. KINNEY, JAMES A. FINK, JR., DEBORAH W. FINK, AND JOHN C. LINDSAY,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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ARGUMENT

I. CONTRARY TO RESPONDENTS' CONTENTIONS, HENDRICK AND THE TRUSTEE WERE DENIED ACCESS TO MATERIAL INFORMATION ABOUT PFC'S FINANCES PRIOR TO THE SALE

Respondents' description of the facts is inaccurate or misleading in three significant respects. All three relate to the assertion that Hendrick had ready access to all of PFC's financial information prior to the February 13, 1985 sale. First, notwithstanding respondents' contention to the contrary, *see* Respondents' Brief, at 3, Hendrick did not have access to such information by virtue of any order entered in *Collins v. PFC, Inc.*, No. 83-CP-16-570, a South Carolina state court suit. On its face, the specific order issued in that litigation on which respondents rely provides only that the *plaintiff* there shall have access to PFC's financial information. *Id.*, at A-3. Hendrick was not the plaintiff in that case. He was a defendant. Both of the other defendants, moreover, refused to furnish Hendrick the desired information.

Second, contrary to what respondents maintain, *see* Respondents' Brief, at 3, the bankruptcy trustee did not have all the most recent financial statements of PFC prior to the February 13 hearing. The most recent statement he had was an unaudited monthly statement for August 1984. The most recent statement that existed, however, which he had not been given, was for January 1985. (R. Ex. 8, at 106; R. Ex. 8, at 36). The latter, prepared within one month of the hearing and in contrast to the August 1984 statement, shows the company doing well. It shows pre-tax earnings increasing by more than 50% over the preceding year and sales increasing by more than 30% during roughly the same period. Neither Hendrick nor

the trustee was aware of this information. Only respondents were aware of it. Equally important, neither Hendrick nor the trustee knew prior to the sale that shortly before then respondents had consummated a secret deal (1) to purchase some of Fink's stock and pay him $750,000, (2) to withdraw $500,000 from the company as part of a bogus stock redemption, and (3) to convert PFC to Subchapter S and distribute earnings to all shareholders.

Finally, respondents' contention that Hendrick had ready access to discovery devices prior to the sale is highly misleading. *See* Respondents' Brief, at 14. Less than two months elapsed between the date of the purchaser's offer and the date the bankruptcy court held the hearing on the trustee's application to sell the stock. It is undisputed that, during that period, respondents pressured the trustee to act quickly or otherwise lose their offer and that the trustee was threatened with a lawsuit if the offer was not accepted. Respondents have never explained, moreover, how during the period in question their identities could have been discovered, depositions scheduled, documents produced, and further discovery taken of lending institutions and other third parties. Additionally, respondents ignore the fact that the trustee did make repeated inquiries before the sale and that respondents themselves gave evasive, misleading answers. Most important, perhaps, Hendrick's counsel called Fink to testify under oath at the February 13 hearing, but, instead of testifying truthfully, Fink perjured himself. Only after the sale did Hendrick and the trustee discover the perjury. Indeed, only after two years, dozens of depositions, and the production of thousands of pages of documents did the true story emerge. The Fifth Circuit

acknowledged that, "at the time of the bankruptcy ruling, neither Hendrick nor the court had full knowledge of all that had taken place in a complex scheme of facts . . . The facts asserted by Hendrick, if true, are quite convincing that he clearly did not know the whole story and serious misrepresentations were made." *See* Appendix to Petitioner's Original Brief, at 6a, 9a.

In sum, Hendrick did not have all material information about PFC's finances prior to the sale, did not have a reasonable opportunity to obtain that information before then, but nonetheless made a reasonable effort to obtain it before then. Respondents' contentions to the contrary are without merit.

II. CONTRARY TO RESPONDENTS' CONTENTIONS, THE CAUSES OF ACTION IN THIS PROCEEDING AND THE PRIOR PROCEEDING ARE NOT THE SAME

In his original brief, Hendrick showed that *res judicata* is inapplicable here because his present claims did not even accrue until *after* the bankruptcy court allegedly entered a final judgment authorizing the sale and thus could not possibly be identical to any claims he did or might have litigated in the bankruptcy proceeding prior to the sale. Nowhere in their brief do respondents address this point. What respondents do, instead, is attempt to show that Hendrick should be barred from pursuing his present claims because the issues on which the claims are based were allegedly litigated in the bankruptcy proceeding prior to the sale. In other words, without ever saying so, what respondents do is attempt to support the judgment in their favor by invoking the doctrine of collateral estoppel and by ignoring the fact

that *res judicata* is inapplicable here as a matter of simple logic.

Collateral estoppel was not the basis of either lower court's decision. Neither the district court nor the Fifth Circuit even addressed the issue. Moreover, collateral estoppel is inapplicable here. "Collateral estoppel treats as final only those questions *actually* and *necessarily* decided in prior suit." *Brown v. Felsen*, 442 U.S. 127, 140 n.10, 99 S.Ct. 2205, 2213 n.10 (1979) (emphasis added); *see also Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 973 (1979); *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326 n.5, 99 S.Ct. 645, 649 n.5 (1979). According to respondents, the central question regarding the sale in the bankruptcy proceeding was whether the proposed price was adequate and appropriate. *See* Respondents' Brief, at 12. This question, however, was neither actually nor necessarily litigated in the bankruptcy proceeding. The bankruptcy court neither valued the stock nor made any determination that the offer was adequate. The order authorizing the sale contains *no* finding of value or adequacy. Indeed, the bankruptcy court's oral reasons, cited in the order, negate any inference that a valuation was made or that the price was determined to be adequate. *See* Petitioner's Original Brief, at 4-5. The bankruptcy court expressly stated that the facts to determine the matter were unavailable, and ordered an investigation. In short, the valuation issue was not actually litigated in the prior proceeding.

Nor was the litigation of the issue necessary for the bankruptcy court to authorize the sale. The applicable provision of the Bankruptcy Code, 11 U.S.C. § 363(b), provides no standard for approving a sale proposed by a trustee. It requires only notice and the opportunity for hearing:

> The trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate.

Since no valuation is required as a prerequisite to the transfer of assets under the Bankruptcy Code, and since none was made here, no basis exists for finding that the bankruptcy court either necessarily valued Hendrick's stock or necessarily determined the offer to be appropriate or adequate.

Additionally, even if the issue had actually and necessarily been litigated in the bankruptcy proceeding, collateral estoppel would bar relitigation only if Hendrick had had a fair and reasonable opportunity to litigate it prior to the sale. *Restatement (Second) of Judgments* ¶ 28(5)(c) (1982); *see also Nevada v. United States*, 463 U.S. 110, 129, 15, 103 S.Ct. 2096, 2918, 2921 (1983) (relying on *Restatement* for guidance). Hendrick has previously shown that he lacked a full and fair opportunity to litigate the issue prior to entry of the final judgment regarding the sale in the bankruptcy proceedings. *See* Petitioner's Original Brief, at 10-15. Nothing respondents say in their opposition brief shows otherwise.

Respondents further contend that under § 363(m) of the Bankruptcy Code, a Bankruptcy Court's order to sell is a final judgment that has *res judicata* effect. *See* Respondents' Brief, at 16. Respondents have previously cited only three cases in support of this contention: *In re Transcontinental Energy Corp.*, 683 F.2d 326 (9th Cir. 1982); *In the Matter of Bleaufontaine, Inc.*, 634 F.2d 1383 (5th Cir. 1981); and *In re Brookfield Clothes, Inc.*, 31 B.R. 978 (S.D.N.Y. 1983). Respondents' argument is baseless. By its own terms, § 363(m) does not apply to individuals or entities that purchase property fraudulently and in bad faith. Hendrick has alleged, and has introduced evidence to

show, that respondents fit this description.[1] Furthermore, in the cases respondents cite, either the court found that the appellees had acted in good faith, *see Bleaufontaine*, 634 F.2d at 1388-89 and *Transcontinental Energy*, 1 B.R. at 463; or fraud and bad faith were not even an issue. *See Brookfield Clothes*, 31 B.R. at 981. Hence, the reliance by respondents here on § 363(m) is misplaced.

Respondents also cite *Met-L-Wood Corp. v. Pipin*, 861 F.2d 1012 (7th Cir. 1988), which admittedly comes closest to the judgment below in extending the principles of *res judicata*. However, *Met-L-Wood* is inapplicable here because it involved a confirmation order rather than an authorization order, and because the bankruptcy court there never suggested that it was reserving any issue. More fundamentally, the Seventh Circuit in *Met-L-Wood* never discusses how such an order could anticipate and resolve fraud claims relating to the inducement of the sale, claims which could not exist until the sale takes place. Indeed, the Seventh Circuit even recognized the limited role of the court when a sale takes place:

> Under Section 363, the trustee or debtor in possession is the seller and the bankruptcy court gets involved only through the requirement of notice and a hearing. Actually, the statute fails to define the court's role clearly. . . .

Id. at 1016.

The Seventh Circuit found that a *confirmation* order, entered *after* a sale, confirms title in the buyer and precludes the litigation of fraud in inducing the sale, except under Rule 60(b). *Id.* at 1018. Even this hypertechnical reasoning could not apply here, however, because no

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[1] Additionally, under § 363(n), a sale may be voided "if the sale price was controlled by an agreement among potential bidders at such sale," as Hendrick has also alleged.

confirmation order was ever issued. Instead, an investigation was ordered.

Unlike the bankruptcy court in *Met-L-Wood*, the bankruptcy court here issued repeated statements and orders that expressly reserved Hendrick's right to bring a suit for fraud. *See* Petitioner's Original Brief at 4-6, 17-19. Respondents do not deny that the bankruptcy court directed the trustee to made an investigation; they do not deny that a minute entry was "filed by the court" (*see* Opinion of Polozola, J., *R. Ex.* 4 at 9) and entered in the record requiring an investigation and, if necessary, a suit; and they do not deny that the bankruptcy court issued numerous subsequent orders authorizing the investigation. Nor do they deny that the Bankruptcy Judge authorized the suit, nor can they since Judge Steen has unequivocally stated: "I authorized – it is no question that I authorized the filing of the Complaint." (*R. Ex.* 19, at 20.)

Finally, respondents ignore the fact that application of *res judicata* to Hendrick's claims would conflict with the RICO statute. Under RICO, Hendrick is entitled to pursue claims based on the predicate acts of bankruptcy fraud, securities fraud and mail fraud. 18 U.S.C § 1961(1). Hendrick's claim based on these predicate acts could not have been brought in the bankruptcy proceeding prior to entry of final judgment on the sale because the claims did not accrue – no bankruptcy fraud or securities fraud was even committed – until *after* entry of the judgment. *See, e.g., Bankers Trust Co. v. Rhoades*, 859 F.2d 1096 (2d Cir. 1988), *cert. denied*, 109 S.Ct. 1643 (1989).

Even at that point, moreover, in light of *H.J. Inc. v. Northwestern Bell Telephone Co.*, 109 S.Ct. 2893 (1989), Hendrick had no RICO claim he could assert. Under *H.J.*

Inc., a "pattern of racketeering activity" ordinarily does not exist unless, at a minimum, the "[p]redicate acts extend[ ] over a few weeks or months[.]" *Id.* at 2902. Here, since the sale occurred on February 13, 1985, no pattern existed and Hendrick's RICO claim did not even ripen until at least March or April 1985, following the initial attempts to conceal the securities fraud and well after entry of the alleged "final" judgment. It is thus manifestly unfair to bar Hendrick from litigating a claim in this action that he could *not* possibly have litigated in the prior action.

III. CONTRARY TO RESPONDENTS' CONTENTIONS, THE FIFTH CIRCUIT'S INTERPRETATION OF RULE 60(a) CONFLICTS WITH THAT OF OTHER CIRCUITS AND IMPERMISSIBLY LIMITS RELIEF UNDER THE RULE

Respondents assert that the Fifth, Ninth and Tenth circuits interpret Rule 60(a) in the same way but simply "have chosen different words to express the rule." Respondents' Brief, at 17. Respondents, however, provide no argument in support of this assertion. Instead, they devote most of their discussion of Rule 60(a) to describing what they think the bankruptcy judge intended when he authorized the sale of the stock and directed the trustee to investigate the matter and file suit if the trustee uncovered wrongdoing by respondents. Neither the Fifth Circuit nor the district court here made this inquiry. Both held that such an inquiry is impermissible under Rule 60(a). Hendrick showed in his original brief that this interpretation is incorrect, *see* Petitioner's Original Brief, at 19-22, and will not repeat the argument here. He respectfully suggests that, should this Court grant his petition and adopt the interpretation followed by the Ninth and Tenth Circuits, the judgment should be

reversed and the case remanded with instructions to consider what the bankruptcy judge intended.

IV. CONCLUSION

Respondents' contentions regarding the facts are misleading in significant respects. Contrary to their contentions, Hendrick was denied access to material information about PFC's finances prior to the sale and did not have full knowledge of the material facts despite repeated inquiries. Indeed, respondents now claim that the trustee and Hendrick should have investigated the matter more fully before the sale, but at the time admittedly pressured the trustee to accept the offer quickly or cause Hendrick to "remain a minority stockholder in the company even though that would not be worth much to him." (R.Ex. 6, at 67; R.Ex. 7, at 123.) On a summary judgment motion, moreover, the facts should be viewed in the light most favorable to the nonmoving party, a standard under which respondents' actions were described by the Fifth Circuit as "quite shocking." See Petitioner's Original Brief, at 6a.

Furthermore, nothing in respondents' brief changes the fact that the Fifth Circuit's decision in this case has created a new rule of *res judicata* in the bankruptcy context that conflicts with both the longstanding rule applied by this Court and the rights afforded by the civil RICO statute. The causes of action in this proceeding and the prior proceeding are not the same. Collateral estoppel is not the basis of the decisions of the lower courts in this case and is inapplicable here. The bankruptcy court neither valued the stock nor made any determination that the offer was adequate, and the bankruptcy court certainly did not consider the fraud issue but, rather,

ordered an investigation to determine the facts and then authorized the filing of the Complaint in this case.

Additionally, the Fifth Circuit's standard for applying Rule 60(a) directly conflicts with that of at least two other circuits, and that conflict merits further review by this Court. The issue before this Court is not necessarily what the bankruptcy court intended by directing the investigation and approving the filing of the Complaint, but rather the standard under which the Fifth Circuit refuses to allow even an inquiry into the bankruptcy court's true intent from the face of the record.

The Petition for Writ of Certiorari should be granted so that the Court may consider the conflicts with judicial precedent and statutory rights presented by the decision of the lower courts in this case.

Respectfully submitted,

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